is $100,000 (which is also the unfunded liability of the plan), and a required $50,000 normal cost contribution is not made for the plan year, the following effects occur. The total unamortized balance of the plan's bases increases by the $50,000 normal cost for the year (adjusted for interest), plus interest on the $100,000 balance of the bases; and, because of that increase, it will take a longer period to amortize the remaining balance of the bases. (The annual amortization amount does not change.)

(8) *Required adjustment to a 10-year base limit adjustment if valuation rate changed.* If there is a change in the valuation rate, the limit adjustment for all unamortized 10-year amortization bases must be changed, in addition to establishing a new base as provided in paragraph (g)(2) of this section. The new limit adjustment for any base is the level amount necessary to amortize the unamortized amount of the base over the remaining amortization period using the new valuation rate. The remaining amortization period of the base is the number of years at the end of which the unamortized amount of the base would be zero if the contribution made with respect to that base equaled the limit adjustment each year. This calculation of the remaining period is made on the basis of the valuation rate used before the change. Both the remaining amortization period and the revised limit adjustment may be determined through the use of standard annuity tables. The remaining period may be computed in terms of fractional years, or it may be rounded off to a full year. The unamortized amount of the base as of the valuation date and the remaining amortization period of that base shall not be changed by any change in the valuation rate.

(i) *Combining bases*—(1) *General method.* For purposes of section 404 only, and not for purposes of section 412, different 10-year amortization bases may be combined into a single 10-year amortization base if such single base satisfies all of the requirements of paragraph (i) (2), (3), and (4) of this section at the time of the combining of the different bases.

(2) *Unamortized amount.* The unamortized amount of the single base equals the sum, as of the date the combination is made, of the unamortized amount of the bases being combined (treating negative bases as having negative unamortized amounts).

(3) *Remaining amortization period.* The remaining amortization period of the single base is equal to (i) the sum of the separate products of (A) the unamortized amount of each of these bases (using absolute values) and (B) its remaining amortization period, divided by (ii) the sum of the unamortized amounts of each of the bases (using absolute values). For purposes of this paragraph (i)(3), the remaining amortization period of each base being combined is that number of years at the end of which the unamortized amount of the base would be zero if the contribution made with respect to that base equaled the limit adjustment of that base in each year. This number may be determined through the use of standard annuity tables. The remaining amortization period described in this paragraph may be computed in terms of fractional years, or it may be rounded off to a whole year.

(4) *Limit adjustment.* The limit adjustment for the single base is the level amount necessary to amortize the unamortized amount of the combined base over the remaining amortization period described in paragraph (i)(3) of this section, using the valuation rate. This amount may be determined through the use of standard annuity tables.

(5) *Fresh start alternative.* In lieu of combining different 10-year amortization bases, a plan may replace all existing bases with one new 10-year amortization base equal to the unfunded liability of the plan as of the time the new base is being established. This unfunded liability must be determined in accordance with the general rules of paragraphs (d) and (f) of this section. The unamortized amount of the base and the limit adjustment for the base will be determined as though the base were newly established.

(j) *Initial 10-year amortization base for existing plan*—(1) *In general.* In the case of a plan in existence before the effective date of section 404(a), the 10-year amortization base on the effective date

of section 404(a) is the sum of all 10 percent bases existing immediately before section 404(a) became effective for the plan, determined under the rules of old section 404(a).

(2) *Limit adjustment.* The limit adjustment for the initial base is the lesser of the unamortized amount of such base or the sum of the amounts determined under paragraph (b)(3) of this section using the original balances of the remaining bases (under old section 404(a) rules) as the amount to be amortized.

(3) *Unamortized amount.* The employer may choose either to establish a single initial base reflecting both all prior 10-percent bases and the experience gain or loss for the immediately preceding actuarial period, or to establish a separate base for the prior 10-percent bases and another for the experience gain or loss for the immediately preceding period. If the initial 10-year amortization base reflects the net experience gain or loss from the immediately preceding actuarial period, the unamortized amount of the initial base shall equal the total unfunded liability on the effective date of section 404(a) determined in accordance with the general rules of paragraphs (d) and (f) of this section. If, however, a separate base will be used to reflect that gain or loss, the unamortized amount of the initial base shall equal such unfunded liability on the effective date of section 404(a), reduced by the net experience loss or increased by the net experience gain for the immediately preceding actuarial period. In this case, a separate 10-year amortization base must be established on the effective date equal to the net experience gain or loss. Thus, if the effective date unfunded liability is $100,000 and an experience loss of $15,000 is recognized on that date, and if the loss is to be treated as a separate base, the unamortized balances of the two bases would be $85,000 and $15,000. If the unfunded liability were the same $100,000, but a gain of $15,000 instead of a loss were recognized on that date, the unamortized balances of the two bases would be $115,000 and a credit base of $15,000. In both cases, if only one 10-year base is to be established on the effective date, its unamortized balance would be $100,000 (the unfunded liability of the plan). See paragraphs (d) and (f) for rules for determining the unfunded liability of the plan.

(k) *Effect of full funding limit on 10-year-amortization bases.* The amount deductible under section 404(a)(1)(A) (i), (ii), or (iii) for a plan year may not exceed the full funding limitation for that year. See section 412 and paragraphs (d), (e), and (f) of this section for rules to be used in the computation of the full funding limitation. If the total deductible contribution (including carryover) for a plan year equals or exceeds the full funding limitation for the year, all 10-year amortization bases maintained by the plan will be considered fully amortized, and the deductible limit for subsequent plan years will not be adjusted to reflect the amortization of these bases.

(l) *Transitional rules*—(1) *Plan years beginning before April 22, 1981.* In determining the deductible limit for plan years beginning before April 22, 1981, a contribution will be deductible under section 404(a)(1)(A) if the computation of the deductible limit is based on an interpretation of section 404(a)(1)(A) that is reasonable when considered with prior published positions of the Internal Revenue Service. A computation of the deductible limit may satisfy the preceding sentence even if it does not satisfy the rules contained in paragraphs (c) through (i) of this section.

(2) *Transitional approaches.* The deductible limit determined for the first plan year with respect to which a plan applies the rules contained in paragraphs (c) through (i) of this section must be computed using one of the following approaches—

(i) The plan (whether or not in existence before the effective date of section 404(a)) may apply the rules of paragraph (j) for establishing the initial base for an existing plan, treating 10-year bases (if any) as 10 percent bases in adding bases.

(ii) The plan may apply the fresh start alternative for combining bases under paragraph (i)(5).

(iii) The plan may retroactively establish 10-year amortization bases for years with respect to which section 404(a)(1)(A) and the rules of this section would have applied but for the transition rule contained in paragraph (l)(1) of this section. Contributions actually

deducted are used in retroactively establishing and maintaining these bases under paragraph (h). However, a deduction already taken shall not be recomputed because of the retroactive establishment of a base.

(m) *Effective date of section 404(a).* In the case of a plan which was in existence on January 1, 1974, section 404(a) generally applies for contributions on account of taxable years of an employer ending with or within plan years beginning after December 31, 1974. In the case of a plan not in existence on January 1, 1974, section 404(a) generally applies for contributions on account of taxable years of an employer ending with or within plan years beginning after September 4, 1974. See §1.410(a)–2(c) for rules concerning the time of plan existence. See also §1.410(a)–2(d), which provides that a plan in existence on January 1, 1974, may elect to have certain provisions, including the amendments to section 404(a) contained in section 1013 of the Employee Retirement Income Security Act of 1974, apply to a plan year beginning after September 2, 1974, and before the otherwise applicable effective date contained in that section.

[T.D. 7760, 46 FR 6914, Jan. 22, 1981; 46 FR 15685, Mar. 9, 1981]

§ 1.404(b)–1 Method of contribution, etc., having the effect of a plan; effect of section 404(b).

Section 404(a) is not confined to formal stock bonus, pension, profit- sharing, and annuity plans, or deferred compensation plans, but it includes any method of contributions or compensation having the effect of a stock bonus, pension, profit-sharing, or annuity plan, or similar plan deferring the receipt of compensation. Thus, where a corporation pays pensions to a retired employee or employees or to their beneficiaries in such amounts as may be determined from time to time by the board of directors or responsible officers of the company, or where a corporation is under an obligation, whether funded or unfunded, to pay a pension or other deferred compensation to an employee or his beneficiaries, there is a method having the effect of a plan deferring the receipt of compensation for which deductions are governed by section 404(a). If an employer on the accrual basis defers paying any compensation to an employee until a later year or years under an arrangement having the effect of a stock bonus, pension, profit-sharing, or annuity plan, or similar plan deferring the receipt of compensation, he shall not be allowed a deduction until the year in which the compensation is paid. This provision is not intended to cover the case where an employer on the accrual basis defers payment of compensation after the year of accrual merely because of inability to pay such compensation in the year of accrual, as, for example, where the funds of the company are not sufficient to enable payment of the compensation without jeopardizing the solvency of the company, or where the liability accrues in the earlier year, but the amount payable cannot be exactly determined until the later year.

[T.D. 6500, 25 FR 11690, Nov. 26, 1960]

§ 1.404(b)–1T Method or arrangement of contributions, etc., deferring the receipt of compensation or providing for deferred benefits. (Temporary)

Q–1: As amended by the Tax Reform Act of 1984, what does section 404(b) of the Internal Revenue Code provide?

A–1: As amended, section 404(b) clarifies that any plan, or method or arrangement, deferring the receipt of compensation or providing for deferred benefits (other than compensation) is to be treated as a plan deferring the receipt of compensation for purposes of section 404 (a) and (d). Accordingly, section 404 (a) and (d) (in the case of employees and nonemployees; respectively) shall govern the deduction of contributions paid or compensation paid or incurred with respect to such a plan, or method or arrangement. Section 404 (a) and (d) requires that such a contribution or compensation be paid or incurred for purposes of section 162 or 212 and satisfy the requirements for deductibility under either of those sections. Thus, for example, under section 404 (a)(5) and (b), if otherwise deductible under section 162 or 212, a contribution paid or incurred with respect to a nonqualified plan, or method or arragement, providing for deferred benefits is deductible in the taxable year

of the employer in which or with which ends the taxable year of the employee in which the amount attributable to the contribution is includible in the gross income of the employee (without regard to any applicable exclusion under Chapter 1, Subtitle A, of the Internal Revenue Code). Section 404 (a) and (d) applies to all compensation and benefit plans, or methods or arrangements, however denominated, which defer the receipt of any amount of compensation or benefit, including fees or other payments. Thus, a limited partnership (using the accrual method of accounting) may not accrue deductions for a fee owed to an unrelated person (using the cash method of accounting) who performs services for the partnership until the partnership taxable year in which or with which ends the taxable year of the service provider in which the fee is included in income. However, notwithstanding the above, section 404 does not apply to contributions paid or accrued with respect to a ''welfare benefit fund'' (as defined in section 419(e)) after July 18, 1984, in taxable years of employers (and payors) ending after that date. Also, section 463 shall govern the deduction of vacation pay by a taxpayer that has elected the application of such section. For rules relating to the deduction of contributions paid or accrued with respect to a welfare benefit fund, see section 419, §1.419–1T and §1.419A–2T. For rules relating to the deduction of vacation pay for which an election is made under section 463, see §301.9100–16T of this chapter and §1.463–1T.

Q–2: When does a plan, or method or arrangement, defer the receipt of compensation or benefits for purposes of section 404 (a), (b), and (d)?

A–2: (a) For purposes of section 404 (a), (b), and (d), a plan, or method or arrangement, defers the receipt of compensation or benefits to the extent it is one under which an employee receives compensation or benefits more than a brief period of time after the end of the employer's taxable year in which the services creating the right to such compensation or benefits are performed. The determination of whether a plan, or method or arrangement, defers the receipts of compensation or benefits is made separately with respect to each employee and each amount of compensation or benefit. Compensation or benefits received by an employee's spouse or dependent or any other person, but taxable to the employee, are treated as received by the employee for purposes of section 404. An employee is determined to receive compensation or benefits within or beyond a brief period of time after the end of the employer's taxable year under the rules provided in this Q&A. For the treatment of expenses with respect to transactions between related taxpayers, see section 267.

(b)(1) A plan, or method or arrangement, shall be presumed to be one deferring the receipt of compensation for more than a brief period of time after the end of an employer's taxable year to the extent that compensation is received after the 15th day of the 3rd calendar month after the end of the employer's taxable year in which the related services are rendered (''the 2½ month period''). Thus, for example, salary under an employment contract or a bonus under a year-end bonus declaration is presumed to be paid under a plan, or method or arrangement, deferring the receipt of compensation, to the extent that the salary or bonus is received beyond the applicable 2½ month period. Further, salary or a year-end bonus received beyond the applicable 2½ month period by one employee shall be presumed to constitute payment under a plan, or method or arrangement, deferring the receipt of compensation for such employee even though salary or bonus payments to all other employees are not similarly treated because they are received within the 2½ month period. Benefits are ''deferred benefits'' if, assuming the benefits were cash compensation, such benefits would be considered deferred compensation. Thus, a plan, or method or arrangement, shall be presumed to be one providing for deferred benefits to the extent benefits for services are received by an employee after the 2½ month period following the end of the employer's taxable year in which the related services are rendered.

(2) The taxpayer may rebut the presumption established under the previous subparagraph with respect to an amount of compensation or benefits

only by setting forth facts and circumstances the preponderance of which demonstrates that it was impracticable, either administratively or economically, to avoid the deferral of the receipt by an employee of the amount of compensation or benefits beyond the applicable 2½ month period and that, as of the end of the employer's taxable year such impracticability was unforeseeable. For example, the presumption may be rebutted with respect to an amount of compensation to the extent that receipt of such amount is deferred beyond the applicable 2½ month period (i) either because the funds of the employer were not sufficient to make the payment within the 2½ month period without jeopardizing the solvency of the employer or because it was not reasonably possible to determine within the 2½ month period whether payment of such amount was to be made, and (ii) the circumstance causing the deferral described in (i) was unforeseeable as of the close of the employer's taxable year. Thus, the presumption with respect to the receipt of an amount of compensation or benefit is not rebutted to the extent it was foreseeable, as of the end of the employer's taxable year, that the amount would be received after the applicable 2½ month period. For example, if, as of the end of the employer's taxable year, it is foreseeable that calculation of a year-end bonus to be paid to an employee under a given formula will not be completed and thus the bonus will not be received (and is in fact not received) by the end of the applicable 2½ month period, the presumption that the bonus is deferred compensation is not rebutted.

(c) A plan, or method or arrangement, shall not be considered as deferring the receipt of compensation or benefits for more than a brief period of time after the end of the employer's taxable year to the extent that compensation or benefits are received by the employee on or before the end of the applicable 2½ month period. Thus, for example, salary under an employment contract or a bonus under a year-end bonus declaration is not considered paid under a plan, or method or arrangement, deferring the receipt of compensation to the extent that such salary or bonus is received by the employee on or before the end of the applicable 2½ month period.

(d) Solely for purposes of applying the rules of paragraphs (b) and (c) of this Q&A, in the case of an employer's taxable year ending on or after July 18, 1984, and on or before March 21, 1986, compensation or benefits that relate to services rendered in such taxable year shall be deemed to have been received within the applicable 2½ month period if such receipt actually occurs after such 2½ month period but on or before March 21, 1986.

Q–3: When does section 404(b), as amended by the Tax Reform Act of 1984, become effective?

A–3: With the exceptions discussed below, section 404(b), as amended, and the rules under Q&A–2 are effective with respect to amounts paid or incurred after July 18, 1984, in taxable years of employers (and payors) ending after that date. In the case of an extended vacation pay plan maintained pursuant to a collective bargaining agreement (a) between employee representatives and one or more employers, and (b) in effect on June 22, 1984, section 404(b) is not effective before the date on which such collective bargaining agreement terminates (determined without regard to any extension thereof agreed to after June 22, 1984). For purposes of the preceding sentence, any plan amendment made pursuant to a collective bargaining agreement relating to the plan which amends the plan solely to conform to any requirement added under section 512 of the Tax Reform Act of 1984 shall not be treated as a termination of such collective bargaining agreement. For purposes of this section, an ''extended vacation pay plan'' is one under which covered employees gradually over a specified period of years earn the right to additional vacation benefits, no part of which, under the terms of the plan, can be taken until the end of the specified period.

[T.D. 8073, 51 FR 4321, Feb. 4, 1986; 51 FR 7262, Mar. 3, 1986; 51 FR 11303, Apr. 2, 1986, as amended by T.D. 8435, 57 FR 43896, Sept. 23, 1992]